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IN THE

Supreme Court of the United States

OCTOBER TERM, 1943.

No. 620.

INTERNATIONAL HARVESTER COMPANY, *Appellant*,

v.

WISCONSIN DEPARTMENT OF TAXATION, *Appellee*.

On Appeal from the Supreme Court of Wisconsin.

APPELLANT'S REPLY BRIEF.

THE CONFLICT BETWEEN THIS COURT AND THE WISCONSIN SUPREME COURT IN THE CONSTRUCTION OF THE CHALLENGED TAX IS VITAL AND UNMISTAKABLE.

In an effort to avoid the issue now for the first time squarely presented in this Court Appellee boldly asserts that between the 1940 decision of this Court in *Wisconsin v. J. C. Penney Co.* (1940), 311 U. S. 435; 82 L. Ed. 267, and the recent decisions of the Wisconsin Supreme Court

in *Blied* v. *Wisconsin Foundry & Machine Co.*, 243 Wis. 221, *Wisconsin Gas & Electric Co.* v. *Tax Commission*, 243 Wis. 216, and in the instant case, no conflict exists in respect to the *construction* of the Wisconsin Privilege Dividend Tax Act. Appellee, to support this assertion, even quotes the opinion of the Wisconsin Supreme Court in the instant case. The language so quoted declares that "*we perceive no conflict so long as we are talking about the power of Wisconsin to tax as against the contention that the subject of the tax is beyond her borders, and hence, beyond her jurisdiction.*" However, the Wisconsin court in the very same paragraph in which appears this disclaimer of any conflict *as to jurisdiction to tax*, reiterates its construction of the law, saying: "We adhere to our determination upon remand of the *Penney case*, *supra*, that this is a privilege dividend tax * * *." In the companion case decided on the same day, *Wisconsin Gas & Electric Co.* v. *Tax Commission*, *supra*, the Wisconsin court categorically states (p. 220):

> "We are certain of three things: (1) that the burden of the tax is specifically laid upon the stockholder; (2) that the corporation declaring the dividend must deduct the tax from the dividend and may not under any circumstances treat the tax as a necessary expense of doing business; (3) that the power to levy the tax so construed was authoritatively established in the *Penney case*."

That this Court, contrariwise, had previously sustained the law upon the concept that it was "an additional tax on corporate earnings within Wisconsin", "a supplementary tax on the Wisconsin earnings of such corporations", and was supported by the "substantial privilege of carrying on business in Wisconsin" which had been granted to the corporation, is not open to argument. We had supposed that much was clear, but took precaution to set forth in a footnote at page 15 of Appellant's Brief excerpts from the minority opinion of this Court in the *J. C. Penney case* and

from the lower federal courts, showing that this was the uniform acceptance of the majority opinion in the *Penney case*. Indeed, it seems perfectly clear that only as a supplemental income tax against the corporation measured by the earnings which the corporation had derived from property and business in Wisconsin and paid out in dividends, was the law susceptible of being sustained. This Court, in the *Penney case*, to sustain the law, said (p. 444-445):

> "The substantial privilege of carrying on business in Wisconsin, which has here been given, clearly supports the tax, and the state has not given the less merely because it has conditioned the demand of the exaction upon happenings outside its own borders. The fact that a tax is contingent upon events brought to pass without a state does not destroy the nexus between such a tax and *transactions within a state for which the tax is an exaction.*" (Emphasis ours.)

Moreover, the court in that case, distinguishing *Connecticut General Life Insurance Co.* v. *Johnson*, 303 U. S. 77; 82 L. Ed. 672, said (p. 445):

> "Nor does *Connecticut General L. Ins. Co.* v. *Johnson, supra* (303 U. S. 77, 82 L. ed. 673, 58 S. Ct. 436), present a barrier against what Wisconsin has done. Its presuppositions recognize the scope of the state taxing power we have outlined, 303 U. S. 77, 80, 82, 82 L. ed. 673, 677, 678, 58 S. Ct. 436. In the precise circumstances presented by the record it was found that the tax neither in its measure nor in its incidence was related to California transactions. Here, on the contrary, the *incidence of the tax* as well as its measure is tied to the earnings which the State of Wisconsin has made possible, * * *." (Emphasis ours.)

Thus it clearly appears from the decision of this Court in the *Penney case* that there still prevails the rule that a transaction tax may be exacted only for transactions within the state, and that the measure and incidence of the tax must be related to transactions which transpire within the taxing state. In view of these prerequisites, a supple-

mentary income tax, measured by Wisconsin income and having its incidence upon the corporation to which the state has granted the privilege of doing business within its borders, would fit into the permissible scope of taxing power. Not so, a tax upon the right of a foreign corporation to declare dividends, nor upon the right of a non-resident stockholder to receive dividends, since both of such rights are enjoyed solely under the laws of a sister state and neither was exercised within the limits of Wisconsin.

Much of the uncertainty and confusion in Appellee's position, as evidenced by its brief here, would have been avoided by a recognition of a few fundamental concepts. At least two of those fundamental concepts are stated in *Home Savings Bank* v. *Des Moines*, 205 U. S., 503; 51 L. Ed., 901. There it was declared (p. 910):

> "It is said that where a tax is levied upon a corporation, measured by the value of the shares in it, it is equivalent in its effect to a tax (clearly valid) upon the shareholders in respect of their shares, because, being paid by the bank, the burden falls eventually upon the shareholders in proportion to their holdings. It was upon this view that the lower court rested its opinion. But the two kinds of taxes are not equivalent in law, because the state has the power to levy one, and has not the power to levy the other. The question here is one of power, and not economics. If the state has not the power to levy this tax, we will not inquire whether another tax, which it might lawfully impose, would have the same ultimate incidence. Precisely the same argument was made and rejected in Owensboro Nat. Bank v. Owensboro, 173 U. S. 664; 43 L. Ed. 850; 19 Sup. Ct. Rep. 537."

And from *Owensboro Nat. Bank* v. *Owensboro*, cited in the above quotation, the court quoted:

> "'The argument that public policy exacts that where there is an equality in amount between an unlawful tax and a lawful one, the unlawful tax should be held valid, does not strike us as worthy of serious consideration.'"

Statement of the fundamental distinction between the taxation of a *shareholder* of a corporation and the taxation of the *corporation*, a second concept necessary to be recognized here, was also called for in *Home Savings Bank* v. *Des Moines, supra*, since there was involved a state tax directing that shares of stock of a state bank should be assessed to the bank, rather than to individual stockholders, without permitting in the valuation a deduction on account of bonds of the United States owned by the bank. The court said (p. 910):

> "But the distinction between a tax upon shareholders and one on the corporate property, although established over dissent, has come to be inextricably mingled with all taxing systems, and cannot be disregarded without bringing them into confusion which would be little short of chaos."

As already noted, Appellee rests its case upon the concept that the tax is against the corporation and is supported by privileges granted to the corporation by the state of Wisconsin. However, as we have pointed out at pages 19 to 26 of Appellant's Brief, the Wisconsin Supreme Court, exercising its acknowledged function to construe the state statute, has unequivocally declared that the burden of the tax is upon the stockholder. This the Wisconsin court held specifically in the case brought by the preferred stockholder against his corporation for recovery of the amount of the Wisconsin privilege dividend tax withheld by the corporation from his dividend. (*Blied* v. *Wisconsin Foundry & Machine Co.*, 243 Wis. 221.) In contrast with its present stand, Appellee heretofore, in its Brief Opposing Motion for Rehearing filed in the Wisconsin Supreme Court in the instant case, at page 8 thereof, declared:

> "It is immutably established by the *Wisconsin Gas and Electric case* (June 16, 1943) that the burden of the privilege dividend tax is upon the stockholder. Lest anyone question that the court actually so held,

need we do more than to set out the following statement in that case:

'We are certain of three things: (1) that the burden of the tax is specifically laid upon the stockholder; (2) that the corporation declaring the dividend must deduct the tax from the dividend and may not under any circumstances treat the tax as a necessary expense of doing business; (3) that the power to levy the tax so construed was authoritatively established in the *Penney Case*. It follows that appellants' contentions must fail.' "

The Wisconsin Supreme Court, upon remand of the *J. C. Penney case*, pointed out (238 Wis. 69, 73):

"Under the terms of the statute under consideration no tax is levied until a dividend is declared. When the dividend is declared the dividend belongs to the stockholder. It is a debt of the corporation for the recovery of which the stockholder may maintain an action. Inasmuch as the tax cannot be levied until the dividend is declared if it is not a tax on the privilege of declaring and receiving a dividend as we hold it to be, then it must be a tax on the recipient, a person not engaged in doing business in this state nor a resident thereof."

The fact that the subject of the tax is a *declared dividend* demonstrates its character and fixes its incidence. Dividends are declared from earnings *after* corporate taxes and charges. The tax is not deducted from the amount otherwise declarable as a dividend. It is imposed upon and deducted from the full amount declared.

Upon the declaration of the dividend the *right* of the stockholder to *receive* it attaches. That right, being a debt owing the stockholder by the corporation, is a distinct legal right attaching to the ownership of the stock. (*Beidler* v. *South Carolina Tax Commission*, 282 U. S. 1, 9; 75 L. Ed. 131, 134.) Since the tax is measured by the full amount of the dividend declared and belonging to the stockholder, and is specifically required by the law to be deducted from the amount so belonging to the stockholder, it most certainly

is imposed upon and taken from the stockholder. (*Colorado Nat. Bank* v. *Bedford*, 310 U. S. 41, 52.)

It is argued by Appellee that because the corporation is made liable for the tax, and no personal liability is sought to be imposed upon the stockholder therefor, the law imposes the tax upon the corporation. It is true that in a purely mechanical sense the corporation is required to pay the tax, but the corporation is required by the law to withhold the amount of tax from the dividend declared, and if it does as the law specifies the corporation is not a whit poorer because of the tax. The corporation is merely a collector of the tax for the state, and is directed to reimburse itself as it has the means to do. While it is true that the corporation pays and is made liable to the state for the tax, nevertheless such payment is not in satisfaction of its own liability, but as a withholding agent of the shareholder. Of a similar situation where the Federal Revenue Act of 1864 required corporations to withhold and pay taxes against stockholders in respect to dividends, this Court, in *U. S.* v. *Baltimore & Ohio R. R. Co.*, 17 Wall. 322; 21 L. Ed. 597, 599, said:

> "In the cases we are considering the Corporation parts not with a farthing of its own property. Whatever sum it pays to the Government is the property of another. Whether the tax is five per cent on the dividend or interest, or whether it be fifty per cent, the Corporation is neither richer nor poorer. Whatever it thus pays to the Government, it by law withholds from the creditor. If no tax exists, it pays seven per cent, or whatever be its rate of interest, to its creditor in one unbroken sum. If there be a tax it pays exactly the same sum to its creditor, less five per cent thereof, and this five per cent it pays to the Government. The receivers may be two, or the receiver may be one, but the payer pays the same amount in either event. It is no pecuniary burden upon the Corporation, and no taxation of the Corporation. The burden falls on the creditor. He is the party taxed."

It is even said by Appellee that the burden of the tax is the same whether the corporation withholds the amount of tax from the stockholder's dividend, or whether the corporation fails to withhold and itself absorbs the tax, charging it to surplus. Clearly this is not true as a practical matter even as to the common stockholder, and as to a preferred stockholder entitled to a specified rate of dividend before anything is paid on the common stock there is an obvious and vital difference. The difference is so plain that it needs no elaboration, albeit wholly overlooked by Appellee.

Indeed, the vital difference between a tax against the corporation, whether called a supplemental income tax or by any other name, and a tax against the stockholder, while no less real as between the common stockholder and his corporation, is more apparent in the case of the preferred stockholder entitled cumulatively to a specified rate of dividend. Moreover, the point as to where the burden of the tax is laid, whether imposed on the corporation or on the stockholder, is not a matter of indifference, not "purely a matter between" corporation and stockholder, as Appellee argues. It is a vital matter, involving of necessity "the operating incidence of a challenged tax", the "practical operation" thereof, which are crucial tests in determining whether the tax is constitutional.

We believe we have shown that the tax can no longer be considered as a tax on the corporation's income, nor on the stockholders' income, nor on the privilege of declaring and receiving dividends.

Summarizing briefly, the tax bears no resemblance any longer to a corporate income tax. It is not assessed on income received and the Wisconsin Supreme Court has held that income tax can only be assessed on income received. The corporation paying the dividend is required to withhold the tax from the dividend, and may not absorb the tax as a business expense and deduct it on its Wisconsin income tax return.

The Wisconsin Court has held the tax cannot be sustained as an income tax on the income of nonresident stockholders.

The privilege of declaring dividends is not exercised in Wisconsin, and the privilege of receiving dividends is not exercised in Wisconsin by more than 98 per cent of the stockholders.

Appellee is therefore driven to the position that the dividends can be taxed on the theory that the fund from which they are paid was originally partly derived from Wisconsin.

On this theory a dividend payable from surplus may be declared by a corporation five or ten years after earnings were derived from Wisconsin, and yet the right is asserted to tax the dividend because five or ten years previously part of the fund from which the dividends were paid was derived from Wisconsin.

The Analogy of the Inheritance and Estate Tax Cases is Unsound.

Appellee argues, however, that inheritance and estate taxes have been upheld although the taxing jurisdiction did not grant the privilege to make the transfer, and although the transfer was not effected in the taxing jurisdiction. It is argued that it is the right and not the privilege which is taxed.

But in the case of Appellant's dividends the stockholder in Indiana or Massachusetts who receives a dividend exercises no right in Wisconsin, nor does the corporation exercise any right in Wisconsin with respect to that stockholder.

Appellee also argues that inheritance taxes have also been sustained "where no physical act effectuating the transfer took place within the jurisdiction of the state".

But in such cases of inheritance taxes, either the decedent was a resident of the taxing state or had property having a taxable situs in the taxing state, or the corporation was domiciled in the taxing state. Here the dividend is not received within the state by the nonresident stockholder and the Appellant is not domiciled in Wisconsin.

The question of whether a state could impose an inheritance tax on the value of stock held by a nonresident stockholder simply because the corporation did business in the taxing state and held property there was definitely settled in the negative by this Court in *Rhode Island Hospital Trust Co.* v. *Doughton*, 270 U. S. 69. There South Carolina imposed an inheritance tax on the transfer from a Rhode Island decedent on stock in a New Jersey Corporation. The claim was made because two-thirds of the property of the New Jersey Corporation was in North Carolina, that North Carolina might treat the shares of stock as having situs in North Carolina to the extent of the ratio in value of its property in North Carolina to all of its property. The theory of the State was that the stockholder was the owner of part of the property of the corporation, and that the state which had jurisdiction of any of the corporate property had *pro tanto* jurisdiction to levy inheritance tax on the value of his share of the stock.

This Court refused to concur in this view because, as it said: "The owner of the shares of stock in a company is not the owner of the corporation's property." The Court there quoted at some length from *Van Allen* v. *Assessors*, 3 Wall. 573, 583; 18 L. Ed. 229, 234, as follows:

> "'But, in addition to this view, the tax on the shares is not a tax on the capital of the bank. The corporation is the legal owner of all the property of the bank, real and personal; and within the powers conferred upon it by the charter, and for the purposes for which it was created, can deal with the corporate property as absolutely as a private individual can deal with his own. This is familiar law, and will be found in every work that may be opened on the subject of corporations.
>
> . . . .
>
> The interest of the shareholder entitles him to participate in the net profits earned by the bank in the employment of its capital, during the existence of its charter, in proportion to the number of his shares; and upon its dissolution or termination, to his proportion of the property that may remain of the corporation

after the payment of its debts. This is a distinct independent interest or property, held by the shareholder like any other property that may belong to him.'"

After some examination of state decisions the Court continued:

"But whatever the view of the other courts, that of this court is clear, the stockholder does not own the corporate property. Jurisdiction for tax purposes over his shares can not, therefore, be made to rest on the situs of part of the corporate property within the taxing state."

And again:

"Our conclusion is in accord with the great majority of cases in the state courts where this exact question has arisen. (Citing cases) Tyler v. Dane County (D. C.), 289 Fed. 843, contains a full and satisfactory discussion of the subject in a Wisconsin case which has been followed by the supreme court of Wisconsin in Shepard's Estate, 184 Wis. 88, 197 N. W. 344."

In *Estate of Shepard*, 184 Wis. 88, there was involved the assertion of a Wisconsin inheritance tax on the transfer of stock of a foreign corporation owned by a non-resident decedent, the basis of the claim being that the corporation owned property in Wisconsin. The Wisconsin Supreme Court reasoned thus:

"But if the decedent was not a resident of the state at the time of his death and the person receiving it is a non-resident and the property to be transferred is without the state, then there is no right to tax because the subject matter is beyond the jurisdiction of the court. Either the property transferred must be within th state or the decedent must have died a resident thereof or some recourse to the courts or laws of our state must be necessary to secure the transfer in order to confer jurisdiction to impose a valid tax. Sec. 72.01, Stats. 1923."

And again at page 94:

> "It requires no careful scrutiny of these provisions declaring when a tax shall be imposed to disclose that they do not include the imposition of a tax upon the transfer of stock held and possessed by a nonresident decedent in a foreign corporation having property and being licensed to do business in this state, unless the property of the corporation is held to be the property of the stockholders. But this court has never so held. • • • The supreme court of the United States has never so held. It has declared that the property of the shareholders in their respective shares is distinct from the corporate property, franchises, and capital stock. *Hawley* v. *Malden*, 232 U. S. 1, 34 Sup. Ct. 201; *Eisner* v. *Macomber*, 252 U. S. 189, 40 Sup. Ct. 189. In *Des Moines Nat. Bank* v. *Fairweather*, 263 U. S. 103, 44 Sup. Ct. 23, the court had occasion to point out the difference between corporate assets of the corporation and shares. It held the former belonged to the corporation as an artificial entity and the latter to the stockholders."

See also *Eisner* v. *Macomber*, 252 U. S. 189, 213; 64 L. Ed. 521, 531.

The case of *Rhode Island Hospital Trust Co.* v. *Doughton, supra*, is a definite holding in denial of Appellee's claim now that because part of the stockholder's dividend was derived from surplus which was originally derived from Wisconsin, Wisconsin can tax a portion of that dividend. In *Rhode Island Hospital Trust Co.* v. *Doughton, supra*, a portion of the value of the shares of the corporation was originally derived from North Carolina, and yet North Carolina was not permitted to impose an inheritance tax on a portion of the value of those shares.

We submit that *Rhode Island Hospital Trust Co.* v. *Doughton, supra*, is conclusive authority against the final contention of Appellee's Brief that the tax may be justified on the ground that the fund from which the dividend was paid was originally partly derived from Wisconsin.

The Legislature Has Not Approved the Interpretations of the Courts by Extending the Life of the Tax.

Appellee devotes many pages of its Brief in support of the proposition that the Wisconsin legislature has re-enacted the Wisconsin Privilege Division Tax several times, and that by such re-enactment has embodied in the law the interpretations made by this Court and by the Wisconsin Supreme Court.

We are not clear that we understand what this contention means. We have contended in Appellant's Brief, and reassert here, that the determinations made by the Wisconsin Supreme Court as to the actual operation and incidence of the tax are controlling. But this is far from the proposition presented by the Appellee, if we understand it. To assert that the Wisconsin legislature accepted and incorporated into law by re-enactment all the interpretations made by this Court and the Wisconsin Supreme Court is to strain to the breaking point the rule that re-enactment of a statute ratifies prior administrative rulings and Court decisions.

We would have to ask what interpretation Appellee has in mind. The tax has been designated as a supplementary tax on corporate income. It has been designated as an excise tax. It has been characterized as a tax on the corporation, and it has been characterized as a tax on the stockholder. Appellee contends that the Wisconsin Court did not hold that the tax was one on the stockholder, but their very contention shows that the interpretations of that court were not free from doubt.

If Appellee means that the Wisconsin legislature has approved the formula employed in this case, we must seriously dissent on several grounds.

In the first place the rule that re-enactment of a statute incorporates in the statute the regulations of an administrative body, or the construction given a statute by the Court, applies only where the administrative rulings or

regulations, or judicial constructions have been well and long established, and where the language is dubious or ambiguous.

Louisville & Nashville R. R. v. *United States*, 282 U. S. 740, 751.

The decision in this case was only handed down on June 16, 1943.

The statute extending the term of the Wisconsin Privilege Dividend Tax for another two years was enacted effective June 29, 1943.

Moreover, Appellant filed a petition for rehearing, which was denied on September 14, 1943.

The decision approving the surplus formula, can, we submit, in no sense whatever be said to have been approved by the Wisconsin legislature by extending the life of the tax by a law effective on June 29, 1943. There is no language whatever in the Wisconsin Privilege Dividend Tax Law providing that a formula dividing Wisconsin surplus by total surplus can be used.

The formula set out in the statute is the income tax formula and that is the only formula.

There is no place for construction of language therefore, and no basis for the application of the rule that reenactment of a statute in the case of dubious or ambiguous language ratifies administrative action or court construction of that language.

The sole question is whether under the Wisconsin Privilege Dividend Tax the Wisconsin Department had authority to adopt a new formula unauthorized by the statute. We have submitted under definite decisions of this Court that it had no such authority. Accordingly we submit that the tax assessed on an unauthorized formula is a denial of the due process of law.

AS TO RETROACTIVE OPERATION OF THE TAX.

In asserting that the challenged tax does not operate retroactively Appellant looks solely to the transaction of declaring and receiving dividends, which, of course, is made the occasion for imposing the tax. Nevertheless Appellant, in support of the law generally, argues that while the series of events from conduct of the business resulting in corporate earnings to the final declaration and receipt of the dividend is "one integrated and indivisible transaction", yet it is by reason of the fact that the state has given benefits in respect to the earning of the income and preservation thereof that the state has jurisdiction to tax. Even if this were assumed, for purposes of argument, the first and fundamental privilege, without which there could be no tax, is the license granted by a state to the corporation to do business. It was this "substantial privilege of carrying on business in Wisconsin" which this Court pointed to as supporting the tax, when looked upon as a supplemental income tax against the corporation.

If, as Appellee argues, the privilege of earning income in this state is the *foundation of the tax* clearly the tax could in any event reach only that income earned from the privilege after the enactment of the dividend tax law. Due process requires that a taxpayer should have the privilege of determining for itself whether to transact business within the state upon terms exacted. That, as to conditions imposed by the Privilege Dividend Tax Law the taxpayer could do only *after the enactment of that law.* (See *Welch* v. *Henry*, 305 U. S. 134, 83 L. Ed. 87.)

Clearly cases cited by Appellee on this point, but where there was a single basis and occasion for imposing the tax, as, for example, an income tax on the realization of income or capital gains, lend no support in the situation here presented.

THE FISCAL EFFECT OF HOLDING THE TAX INVALID SHOULD BE GIVEN NO WEIGHT ON THIS APPEAL.

Going outside of the record in the instant case, it is pointed out at page 19 of Appellee's brief that from the date of enactment through the first three months of the present year there has been collected by way of privilege dividend tax upwards of $16,000,000.00. It may be answered that whatever the outcome of this suit, much of the amount thus collected by the state is not open to refund, any rights in that respect having been long since barred. It may be pointed out too that a very substantial amount collected is in respect to Wisconsin corporations and its stockholders, and the validity of the law in respect to them is not here in question. But in any event there is not here involved the "delicate process of fiscal policy-making" with which this Court in the *Penney case* hesitated to inject itself "in a merely negative way." Here we are dealing with a legislative act which was the hasty result of a political compromise, and represents an ingenious attempt to excise a portion of dividends paid to the great number of non-resident stockholders of foreign corporations. Of only temporary character and at a low rate at its inception, the tax has been repeatedly given an extended life and the rate increased, as amply shown by the records in this Court. From its inception this tax has been productive of doubt and litigation, a source of irritation to the stockholders, and a constant cause of uncertainty and difficulty for those called upon to administer it.

In *J. C. Penney Co.* v. *Tax Commission*, 233 Wis. 286, 297, the Wisconsin Supreme Court stated that it had been strongly urged to affirm the judgment in that case "because the state treasury is dependent upon the maintenance of the right of the state to tax dividends of foreign corporations to the extent that such dividends are derived from earnings within the state." It answered:

"The matter of financial exigencies of the state, however, afford no justification for the ignoring of a rule of law laid down by the United States supreme court. The state must find its revenues within the field within which its taxing power may be exerted as prescribed by the constitution and laws of the United States."

THE QUESTION OF THE FORMULA.

Appellee's Brief on page 59 states that scattered through the Brief of Appellant, International Harvester Company, "there are references to details in the computation of the taxes here involved and, if not actually then inferentially, complaining in respect thereto. To the extent any such arguments relate to the details of computation they are foreclosed by and contrary to the stipulation entered into by counsel for appellant" (Case No. 620, R. 30-31) and should be disregarded."

We presume that Appellee refers particularly to the argument beginning on the top of page 45 of Appellant's brief, where it is argued that the formula used by the Wisconsin Department of Taxation and approved by the Wisconsin Supreme Court in this case is radically different from the formula prescribed by the statute.

We respectfully submit that none of the argument in regard to the validity of the formula is foreclosed by the stipulation, Exhibit 7-A (R. 30-31). That stipulation we submit is clear and unmistakable in its meaning. It says simply that the appellant does not contest the computation of the tax on the assumptions made by the Wisconsin Department of Taxation, but it distinctly reserves the right to contest the validity of those assumptions. The second paragraph of the stipulation states that International Harvester Company reserved the right to contest the validity of the Privilege Dividend Tax Law "as applied on the presumption that the International Harvester Company paid its dividends from Wisconsin income in the proportion that its earnings from Wisconsin property and

business reflected in its surplus, bore to its total surplus, or as in any manner applied to the petitioner" (R. 31).

Frankly, we cannot understand how there can be any misunderstanding as to the meaning of the above language. It means, we submit, that the computations are not in contest on the basis of the assumptions made, but that the assumptions are most definitely in contest.

The Wisconsin Privilege Dividend Tax Law provides that the proportion of the dividend attributable to Wisconsin shall be ascertained according to the provisions of Chapter 71. Chapter 71 is the income tax chapter. It provides that the proportion of income attributable to Wisconsin, in the case of a taxpayer doing business within and without the state of Wisconsin, shall be ascertained by applying to the total apportionable net income, the average of three ratios:

> The ratio of tangible property in Wisconsin to total tangible property;
>
> The ratio of sales in Wisconsin to total sales; and
>
> The ratio of cost of manufacturing in Wisconsin to total cost of manufacturing.

The Wisconsin Supreme Court held, in the *Penney case* on remand, that the above formula could not be used when a dividend was paid out of surplus and not out of current earnings, and stated that it would be necessary to find what proportion of the surplus was derived from Wisconsin and apply that proportion to the dividends.

The Wisconsin Department accordingly proceeded to ascertain what proportion of the surplus was derived from Wisconsin. To do that it took the income tax fraction each year and applied it to book net income, and called the result book income apportioned to Wisconsin. It accumulated book net income derived from Wisconsin from year to year in an amount which it called Wisconsin income reflected in surplus or Wisconsin surplus, and

divided that amount by total surplus and applied the resulting fraction to the dividend.

It may be conceded that the Wisconsin Department intelligently and sincerely endeavored to comply with the decision in the *Penney case* on remand, but the more it endeavored to comply with the *Penney* decision, the more it was changing the statute, in short, legislating.

We submit that the Wisconsin Department had an impossible task. It was told by the Wisconsin Supreme Court that where a dividend is paid out of surplus it could not apply the formula provided by the Wisconsin Privilege Dividend tax, the income tax formula, the only one provided by the statute. It was told that it must determine what portion of the surplus of the taxpayer was derived from Wisconsin. It made an intelligent attempt to find such proportion of surplus, and in so doing, we submit, it clearly rewrote a whole section of the statute.

In short, the Wisconsin Department of Taxation was faced with an inescapable dilemma. It was told that it could not use the statutory formula, and yet it has no power to legislate and provide a formula of its own.

The conclusion seems inevitable that the administration of the tax has completely broken down.

Respectfully submitted,

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